

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

77-6114

TO BE ARGUED BY
DAVID C. TOOMEY

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

B
p/s

FRIENDSHIP DAIRIES, INC., POLLIO DAIRY PRODUCTS CORP.,
CROWLEY FOODS, INC., QUEENSBORO FARM PRODUCTS INC.,
SARATOGA DAIRY, INC., DELTOWN FOODS, INC., ELMHURST
MILK AND CREAM CO., INC., QUEENS FARMS, INC., and
CUBA CHEESE AND TRADING CO., INC.,
Plaintiffs-Appellants,

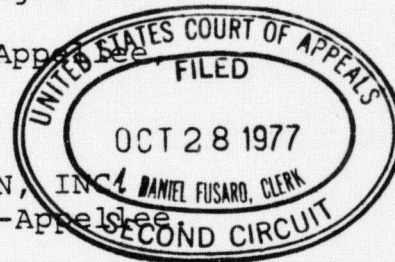
-against-

EARL BUTZ, Secretary of the Department of Agriculture
of the United States

Defendant-Appellee

-and-

PENNMARVA DAIRYMEN'S COOPERATIVE FEDERATION, INC.,
Intervenor-Appellee



From an Order and Judgment of the United States District Court
for the Eastern District of New York in 75c 1517

REPLY BRIEF FOR PLAINTIFFS-APPELLANTS

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INTRODUCTION TO ARGUMENT

Federal Milk Marketing Order No. 21 establishes the monthly minimum prices which handlers in Eastern New York and Northern New Jersey pay farmers for raw milk used to manufacture milk products. Prior to 1974, those minimum prices were established by a formula which was itself composed of two formulas: the minimum price was the lower of the prices produced by (a) the "basic formula" (or "Minnesota-Wisconsin Series") or (b) the "Butter-Powder formula".

In 1974, the formula was "altered" (to use the words of the Secretary in his Brief)² to establish the "basic formula" -- or "Minnesota-Wisconsin Series" -- as the sole basis for determining the minimum price of milk (1139a). Appellants contend that the decision to adopt the Minnesota-Wisconsin Series as the sole method of establishing the minimum price for milk in this market was without substantial evidentiary support, because no evidence was introduced -- despite the efforts of the Appellants and others to obtain it -- which would justify the validity or integrity of the Minnesota-Wisconsin formula standing alone, or its applicability to the New York-New Jersey market.

1. 7 C.F.R. §1002 et. seq.

2. Brief of Secretary of Agriculture (hereafter "Secretary's Brief", or "Secty's Brief") p.5, ¶1.

The Appellees -- the Secretary, and the Intervenor, Pennmarva Dairymen's Federation -- base their entire argument in support of the amendment on the premise that the use of the Minnesota-Wisconsin Series was never at issue in the hearing; thus, they reason, there was no call for anyone to offer evidence supporting it. Appellees contend that the only issue was whether the Butter-Powder formula should be removed, and cite evidence offered by those who sought its removal.

In this Reply Brief, we first touch upon certain grievous overstatements which appear in the Appellees' Briefs which distort the economic circumstances existing at the time of the hearing, the economic effect if this Court should reverse the District Court and vacate the Secretary's Order, and the Appellants' motivation in bringing the case. In Part II, we respond to the argument that the Minnesota-Wisconsin Series was never at issue in this case, and show, inter alia, that the hearing notice itself put the Minnesota-Wisconsin Series in issue. In Part III, we conclude by demonstrating that the Order was not supported by record evidence, a conclusion which is inadvertently conceded by Appellees' reliance on material which was not made part of the record at the rulemaking hearing.

ARGUMENT

I. APPELLEES HAVE OVERSTATED THEIR CASE AND DISTORTED THE RECORD

Both the Secretary and Pennmarva have sought in their Briefs to depict a drama of melodramatic proportions. The farmers are seen as economically helpless waifs, about to be engulfed by an onrushing steamroller of adverse economic events; the Appellants are the villains, lashing the farmers to the tracks to preserve some economic "bonanza"³; and the Secretary is the hero, riding furiously to the rescue. We are told that a crisis existed, requiring prompt and effective aid;⁴ and it is stated that if this Court steps in to interfere with the Secretary's handling of this perceived crisis, the entire national milk marketing system for both fluid and manufacturing milk will be destroyed.⁵

Appellees obviously seek to create a crisis atmosphere in order to justify the Secretary's failure to follow the requirements of the law, and to avoid the consequences of that failure; we submit, however, that Appellees reveal the weakness

3. Pennmarva Br., p.9

4. Although in fact almost all of the farmer groups -- including all of the New York farmer groups -- rejected the notion that there was a crisis (266a, 290a, 304a, 428a-29a, 563a, 565a-66a, 604a).

5. Secretary's Brief, p. 14 n.9, and p. 37, n. 18.

of their position by resorting to such devices. We believe that some response is required in order to place this case in its proper perspective.

A. The Economic Evidence Is Grossly Distorted.

Throughout the Brief of both Appellees, statements appear which -- at face value -- would make it appear that farmers were suffering grievous financial losses. Thus, we are told that:

"Beginning in October, 1973 ... the b-p prices dropped precipitously ..." (Secty. Br., p. 15)

"[T]he price of Class II milk [declined] ... " (Ibid.)

"Farmers in Order No. 2 alone had lost some 10.7 million dollars ... over the preceding four month period." (Id. at 22)

"[The B-P formula had a] depressing effect on the blend price ... (Id at 25).

"[T]he b-p price fell below the M-W Series ... " (Pennmarva Br., p. 5)

"The radical decline in the b-p price which began in October of 1973 resulted in a

significant drop in the blend price paid to producers..." (Id. at 6).

"The decline in the blend price was substantial." (Id. at 7).

Similar statements appear throughout Appellees' Briefs.

When one looks to the Record, however, one finds evidence which confounds these statements, including the very exhibits cited for their support. In Exhibit X10 (933)⁶, one sees that the Butter-Powder formula (referred to in the Exhibit as the "Snubber") went up dramatically from October to December, 1973. Exhibit X24 (938a) shows that from January 1972 through December 1973, the Butter-Powder formula increased steadily from \$4.93 per cwt. to \$6.81, an increase of almost 50%. From December 1972 to December 1973, the blend price -- the farmers' take-home pay --- had increased 49% (637a-38a).

The difference between the Appellees' statements and the record facts is to be found in the perspective from which the Appellees write. What the exhibits show is that the Minnesota-Wisconsin Series was skyrocketing in relation to the Butter-Powder formula. The Butter-Powder formula was not dropping "precipitously"⁷ -- it was increasing -- but the

6. Cited by the Secretary in his Brief at p. 15.

7. Secretary's Brief, p. 15.

resulting prices of the two formulae were growing farther apart; the farmers "lost" money only in the sense that, with the Butter-Powder formula, they did not make as much more in 1973 as they would have if prices had been set by the M-W Series alone; and the blend price did not decline -- it increased -- but not to the extent that it would have, had the M-W Series been the determinative price-setter.

By citing these examples, we do not mean to suggest that the farmers were rolling in money. We readily acknowledge that their production costs had increased substantially, in large measure for reasons totally unrelated to pricing policy, and unresolvable in a price hearing. The economic situation of the farmer may well justify a thoughtful analysis on a fully-developed hearing record. We cite these instances of semantic gamesmanship, however, as typical of the distorted picture which Appellees attempt to draw in an attempt to persuade this Court to be lenient with the Secretary's actions.

That distortion extends to the uncalled-for characterizations of the Appellants' motives which appear in the Briefs.

B. Appellees Have Totally Mischaracterized The Appellants' Position In This Case.

The Appellees, having claimed the higher ground of economic rectitude, malign the Appellants as seekers after venal profit at the expense of their competitors.

Thus, we are told that Appellants' "entire attack" derives from their desire to enjoy "competitive advantages"⁸ over those who pay minimum prices based solely on the M-W Series; that Appellants "apparently" were enjoying a "bonanza"⁹; and that Appellants seek to prevent their being deprived of an "economic windfall".¹⁰

The only record evidence cited to the effect that Eastern manufacturers would have an advantage over other manufacturers was the testimony of Mr. Berkhahn of the National Farmers Organization, at pp. 38-40, n. 193. Mr. Berkhahn was a farmers' representative from Iowa (10a) who concededly did not even have knowledge of Eastern farmers' costs,¹¹ to say nothing of manufacturers' costs.

In fact, as we discussed in our Main Brief at pp. 11-13, the record is overwhelming and unrebutted that Eastern manufacturers had already suffered severe competitive disadvantages, even in their own natural markets, vis-a-vis Wisconsin and Minnesota manufacturers, in part as the result of Federal regulation.

8. Secretary's Brief, pp. 36, 38.

9. Pennmarva Brief, p. 9.

10. Id. at 12.

11. 46a.

Appellants had (and have) a legitimate right to attempt to protect themselves against arbitrary administrative action. Their products are extremely price elastic -- as costs are passed on in higher prices, demand decreases.¹²

Appellees' efforts to cast the parties as relatively "good" and "bad" add nothing at all to the analysis of the problem before the Court. Appellees' characterization of the Appellants pales, however, before the Appellees' misrepresentation of the effects of a reversal in this case.

C. The Appellees Misstate The Relief Which Appellants Seek.

In an effort to insulate his Order from careful review by the Court, the Secretary poses certain cataclysmic results which he suggests will follow if his wisdom is questioned.

In footnote 9, page 14, the Secretary states that, although appellants are not challenging the Class I price for fluid milk "directly", a decision by the Court invalidating the M-W Series as a determinant of Class II prices would also invalidate it as a Class I pricing mechanism. In footnote 18, page 37, the Secretary states that a finding that the M-W price is invalid will, as a practical matter, destroy milk pricing

12. See. e.g. 310a-12a, 640a, 641a, 647a.

throughout the nation. The Secretary raises the spectre of a national disaster, apparently hopeful that the Court will shy away from such a Draconian result, without looking too closely at the fantasy which the Secretary concocts.

To begin with, Appellants have appealed only the Amendments to Order No. 2, which relate only to manufacturing milk. The similar Amendments to the other Northeast Orders, and whatever similar provisions that may exist in other Orders in the country are not, to our knowledge, being attacked in Court. We think that they were subject to attack, but they were not attacked and thus stand as final Orders.

More importantly, we do not seek to invalidate the M-W Series in this appeal. Such a goal would be thwarted by the same infirmity which attends the Order which we appeal: the M-W Series can neither be thrown out entirely nor imposed as the sole determinant of prices, because there is no evidence in the record regarding the details of the Series, its validity or invalidity, its applicability or inapplicability, and its integrity or lack of same. It cannot be imposed as the sole price determinant because it has not been justified, and it cannot be thrown out because its invalidity has not been shown -- no one has the facts with which to analyze the Series except the Secretary, and he has chosen to say nothing.¹³

13. This is not to say that, if the case is remanded, such an effort will not be made. The effort certainly will be made, and the concerns voiced in the cited footnotes may well be material at that time -- but not now.

Indeed, this Court could not grant that relief, even if we sought it. Under Section 15(B) of the Act,¹⁴ the Court can only vacate the Order which amended the Marketing Order and remand the case to the Secretary. As the Secretary well knows, the invalidation of the Minnesota-Wisconsin Series -- on this record -- is beyond the Court's jurisdiction; we seek only to vacate the Amendment which imposed the M-W Series as the determinant of manufacturing milk prices, and an Order remanding the case to the Secretary with directions to conduct a proper hearing, including an in-depth examination of the M-W Series if the Secretary seeks to reimpose the amendment.

D. Summary.

We have detoured from the issue in this appeal because the Appellees so distort the nature of the case in their Briefs that some effort is necessary to thwart their attempts at overkill. The Appellants are simply manufacturers of milk products who, if they are to be regulated, insist upon their right to be regulated within the framework of the law. No crisis

14. "...If the court determines that such ruling is not in accordance with law, it shall remand such proceedings to the Secretary with directions either (1) to make such ruling as the court shall determine to be in accordance with law, or (2) to take such further proceedings as, in its opinion, the law requires..." Agricultural Marketing Agreements Act, §15(B); 7 U.S.C.A. §608c(15)(B).

existed of such magnitude as would justify the Secretary's evasion of the requirement that his Order be based upon substantial evidence. The Appellants' position is that there was no substantial evidence to support the Orders, that it should be vacated and the regulatory status quo ante-1974 reinstated, and that the case should be remanded to the Secretary for proper hearings.

II. THE USE OF THE MINNESOTA-WISCONSIN SERIES WAS THE SOLE
ISSUE IN THE CASE

As we have noted above, the Appellees' strategy is to justify the lack of evidentiary support for the Minnesota-Wisconsin Series by arguing that its validity and applicability were never at issue. They argue that the Minnesota-Wisconsin Series was beyond the scope of the hearing,¹⁵ and that, in the words of the Court below, it was a "given" of the hearing.¹⁶ Thus, they say, no evidence was necessary to support the decision to use the Series as the sole basis for pricing milk.

The Appellees, and the Court below, are simply incorrect. In the words of the Secretary himself, the Order "alter[ed] the existing pricing formula".¹⁷ With

15. Secretary's Brief, p. 27; Pennmarva Brief, p. 14-16.

16. Secretary's Brief, p. 29; Pennmarva Brief, p. 15.

17. Secretary's Brief, p. 5.

the Butter-Powder formula removed, an entirely new formula existed -- the Minnesota-Wisconsin Series standing alone. The validity and applicability of that formula -- acting alone without the restraining influence of the Butter Powder formula -- was the subject matter of the hearing. One cannot deal with the removal of the Butter-Powder formula in a vacuum, without looking at what is left and determining whether that which is left "effectuate[s] the declared policy of [the Act]": 7 U.S.C.A. §608c(4). That look was never taken; the failure to take the look is the cause of this action.

Both the Secretary and Pennmarva argue that the Butter-Powder formula could be removed without looking at the Minnesota-Wisconsin Series because it was but an addendum to the Minnesota-Wisconsin Series. Pennmarva states¹⁸ that the M-W Series had existed in Order No. 2 since 1961 until the Butter-Powder formula was introduced as "an alternative". It suggests that the Butter-Powder formula was no longer necessary, so the status quo prior to 1968 was just being restored.

This argument is simply not correct. Before 1968, the price of manufacturing milk in Order No. 2 was determined by a totally different formula known as the United States Average Manufacturing Milk Price. That formula was replaced by the combination of the Minnesota-Wisconsin Series and the

18. Pennmarva Brief, p. 14.

Butter-Powder formula which existed until the hearing in this case (see generally 33 F.R. 7184 et seq.). The Minnesota-Wisconsin Series had never stood alone in the New York-New Jersey Market until the present Order (Ibid.). The purpose of adopting the formula composed of the lower of the M-W Series or the Butter-Powder Formula was not, as the Appellees argue, to "clear the market" of reserve milk; it was to "protect handlers against unreasonably depressed operating margins": 33 F.R. at 7184. Margins, of course, are the difference between sales prices and costs, the largest of which is the cost of raw milk. The combination of formulae was clearly designed to keep handlers' costs at such a level that they could move the farmers' milk to the market and still receive a reasonable return for their efforts, irrespective of the type of product involved (33 F.R. at 7185).

Since the Minnesota-Wisconsin Series had never stood alone as a price determinant in this market, the adoption by the Secretary of the Minnesota-Wisconsin Series standing alone in this case was the adoption of an entirely new pricing theory, despite the suggestions of the Appellees to the contrary.

The Secretary argues that it is up to him to decide what proposals he will hear, and what he will not hear; it is said that the only proposals he agreed to hear were to remove the Butter-Powder formula, and that phrasing the issue as being whether the Minnesota-Wisconsin Series should be used alone,

raises a "collateral matter".¹⁹ We reject the notion that the Secretary can tinker with parts of a formula without analyzing the whole; but assuming arguendo that the Secretary is right, the facts contradict his assertion. The very language of the Proposals brought the Minnesota-Wisconsin Series into the case. Proposal No. 1 stated:

"In §...1002.50a(c)...delete the language preceeding the table therein and replace with the following:

"(c) Subject to the adjustment set forth below to the applicable month, the Class II price shall be the basic formula price for the month." (Emphasis added)
(3a).

The basic formula price" is the Minnesota-Wisconsin Series.²⁰ And that precise language was the language adopted by the Secretary in his final Order (1139a). Thus, the issue whether the Class II price should be the basic formula price was directly before the Secretary in this case, although he

19. Secretary's Brief, p. 28.

20. "The 'basic formula price' shall be the average price per hundredweight for manufacturing grade milk, f.o.b. plants in Minnesota and Wisconsin, as reported by the Department for the month, adjusted to a 3.5 percent butterfat basis and rounded to the nearest cent..." 7 C.F.R. §1002.50.

now focuses on only the introductory words of the proposal, and the not the amendatory words themselves.²¹

Thus, the validity and use of the Minnesota-Wisconsin Series was never a "given" of the hearing -- except insofar as the Secretary treated it as a "given" by refusing to produce evidence concerning it. Appellants' position was, and still is, that the Minnesota-Wisconsin Series is inapplicable to the Northeast, and is subject to improper influences by the large cooperative organizations which dominate the Minnesota and Wisconsin dairy industry. Appellants moved throughout the hearing for the production of material held by the Secretary which would permit the Series' analysis (1420-480, 491a, 657a). Those Motions were denied; thus, the record does not contain evidence which justifies the Series' use.

-
21. As a variant on the Secretary's argument, Pennmarva argues that the implication of Appellants' contention is that every Order provision must be justified whenever a hearing is called. The short answer is that no such argument is made; Appellants' contention is that if the Secretary is going to change a formula, he cannot pick and choose among parts of the formula, but must consider the validity and applicability of the formula as a whole, as it is proposed to be changed.

It is also argued, that no evidence on the M-W Series was necessary because it had existed in the past and thus the "status quo" was merely being maintained (Secretary's Brief, p. 30; Pennmarva Brief, p. 14-15). We contrast that statement with the dramatic statements of portending economic disaster discussed above, which the Secretary sought to solve by revision of the formula. Obviously, a drastic revision of the method of pricing manufacturing milk was contemplated. The Secretary himself states that the Order "alter[ed] the existing pricing formula" (Brief, p. 5). The status quo was not maintained; rather, a new revised formula came into effect.

III. THERE IS NO EVIDENCE IN THE RECORD TO JUSTIFY THE
IMPOSITION OF THE MINNESOTA-WISCONSIN SERIES AS THE SOLE
BASIS FOR PRICING MILK USED IN MILK PRODUCTS

Appellees have made no effort to claim that the record of the rulemaking hearing supports the validity and use of the M-W Series standing alone as the method of setting minimum prices -- indeed, the lack of a record is the necessary corollary of their position that the M-W Series was not an issue. Instead, they have sought to invoke extra-record materials to justify the Series' use. Nowhere is this better shown than in Appellees' handling of the Dwight Morris deposition (Secretary's Brief, p. 31-34, n. 14).

It will be recalled that Appellants and others had tried to examine the Minnesota-Wisconsin Series because of increasing doubt regarding the integrity and validity of the Series (348a, 573a-79a). The Secretary had refused to supply the secret information necessary to the conduct of such an analysis (589a-91a). After the record of the rulemaking hearing had been closed, but before the Appellants' administrative appeal had been heard, Morris testified in an anti-trust case that, on behalf of the nation's largest cooperative, he had rigged the Series at a cost to handlers and consumers of hundreds of millions of dollars (1227a-37a). Appellants argued that this testimony justified a ruling that the rulemaking hearing record

be reopened, so that full exploration of the Series could be made as they had originally asked (1228a-37a).

Appellees respond by saying²² that any doubt as to the validity of the Minnesota-Wisconsin Series, whether arising from the Morris testimony or otherwise, was refuted and "la[id] to rest"²³ by the Affidavit of Robert March (located at 1332a).

The trouble with Appellees' argument is that the March affidavit was not filed in the rulemaking hearing, but in the administrative appeal hearing five months after the final Order had taken effect. Mr. March did not testify in either hearing, and his conclusory affidavit has never been the subject of cross-examination. The March affidavit is a classic example of the "post hoc rationalizations of agency action" which the Supreme Court condemned in Burlington Truck Lines, Inc. v. United States, 371 U.S. 156, 168, 83 S.Ct. 239, 246 (1962).

Appellees miss the important point, however. The point is not that Morris told the truth, or that March told the truth; the point is that the testimony of the type proffered by these men was the type of testimony which would have been brought out and examined in the light of day if the fully-developed hearing record which Appellants sought had been permitted.

22. Secretary's Brief, p. 31, n. 14; Pennmarva Brief p. 12.

23. Ibid.

The March affidavit was not the only extra-record evidence relied upon by the Secretary. He concedes that in concluding that the Minnesota-Wisconsin was valid, he "rel[ie]d in part ... upon judicial notice of pamphlets published by the Statistical Reporting Service (SRS) of the Department"²⁴ This "judicial notice" did not occur, however, during the rulemaking hearing -- indeed, one of the documents was published two months after the hearing (see Secretary's Brief, p. 34, n. 16). Appellants never had an opportunity to object to the admission of the documents or cross-examine their authors.

Not a single expert witness who testified knew any details concerning the Series (74a-75a, 175a, 300a-01a). The reason is that the Secretary himself is the only one having the facts about it. It is thus no answer for the Secretary to say that he has no obligation to produce testimony.²⁵ That is true, as a general matter; but the Secretary also cannot issue an Order unless it is based on substantial evidence.²⁶

24. Secretary's Brief, p. 31-32. These documents appear in the Joint Appendix at 1061a-82a at the request of counsel for the Secretary. However, it is important to note that they were not part of the record; indeed, one of the documents--"Agricultural Prices, April 1974" -- was not published until after the hearing record was closed.

25. Secretary's Brief, p. 30.

26. Zuber v. Allen, 396 U.S. 168, 90 S.Ct. 314 (1969); Fairmont Foods Co. v. Hardin, 442 F.2d 762 (D.C. Cir. 1971); Abbotts Dairies v. Butz, 389 F. Supp. 1 (E.D. Pa. 1975); Abbotts Dairies v. Hardin, 351 F. Supp. 561 (E.D. Pa. 1972)

If he wishes to issue an Order on a matter as to which he has exclusive possession of the evidence, he either must come forward with the testimony, or risk having his Order set aside. The Secretary's failure to do so in this case has created an Order which, notwithstanding his obfuscation of the issue and his resort to extra-record evidence, is invalid because of its lack of evidentiary support.

CONCLUSION

For the reasons set forth above, and in our Main Brief, we respectfully request your Honorable Court to reverse the Order and Judgment of the Court below, vacate the 1974 Amendments to Order No. 2, and remand the case to the Secretary for further proceedings.

Respectfully submitted,

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and

PENNMARVA DAIRYMEN'S COOPERATIVE
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Intervenor-Appellee

NO. 77-6114

CERTIFICATE OF SERVICE

David C. Toomey, Esquire, hereby certifies that he
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and that he has served two copies of the Reply Brief in this
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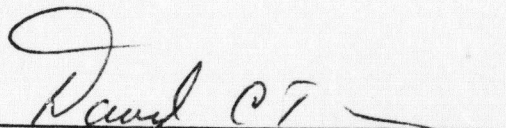
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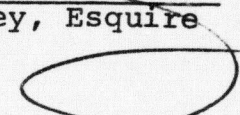
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